

Educational

Nominal Anchor for Monetary Policy

A nominal anchor for monetary policy is a single variable or device which the central bank uses to pin down expectations of private agents about the nominal price level or its path or about what the Bank might do with respect to achieving that path (Krugman, 2003). Generally, the two kinds of nominal anchor; quantity-based nominal anchor and price-based nominal anchor. The quantity based nominal anchor targets money while the price-based nominal anchor targets exchange rate or interest rate. In the past the CBN uses broad money supply (M2) as the nominal anchor for monetary policy. It is important to note that exchange rate targeting may not produce the desired effect if the interest rate is also subject to control at the same time. Some rules are necessary for effective monetary policy. In this case, prices such as exchange rate and interest rate may not be controlled or pegged at the same time. If interest rate is controlled, the exchange rate should be allowed to move freely for the necessary adjustment to materialise so that price stability could be attained.